

# DEVELOPING TRENDS IN SHIP FINANCE:

## Current Enforcement Scenarios and New Challenges

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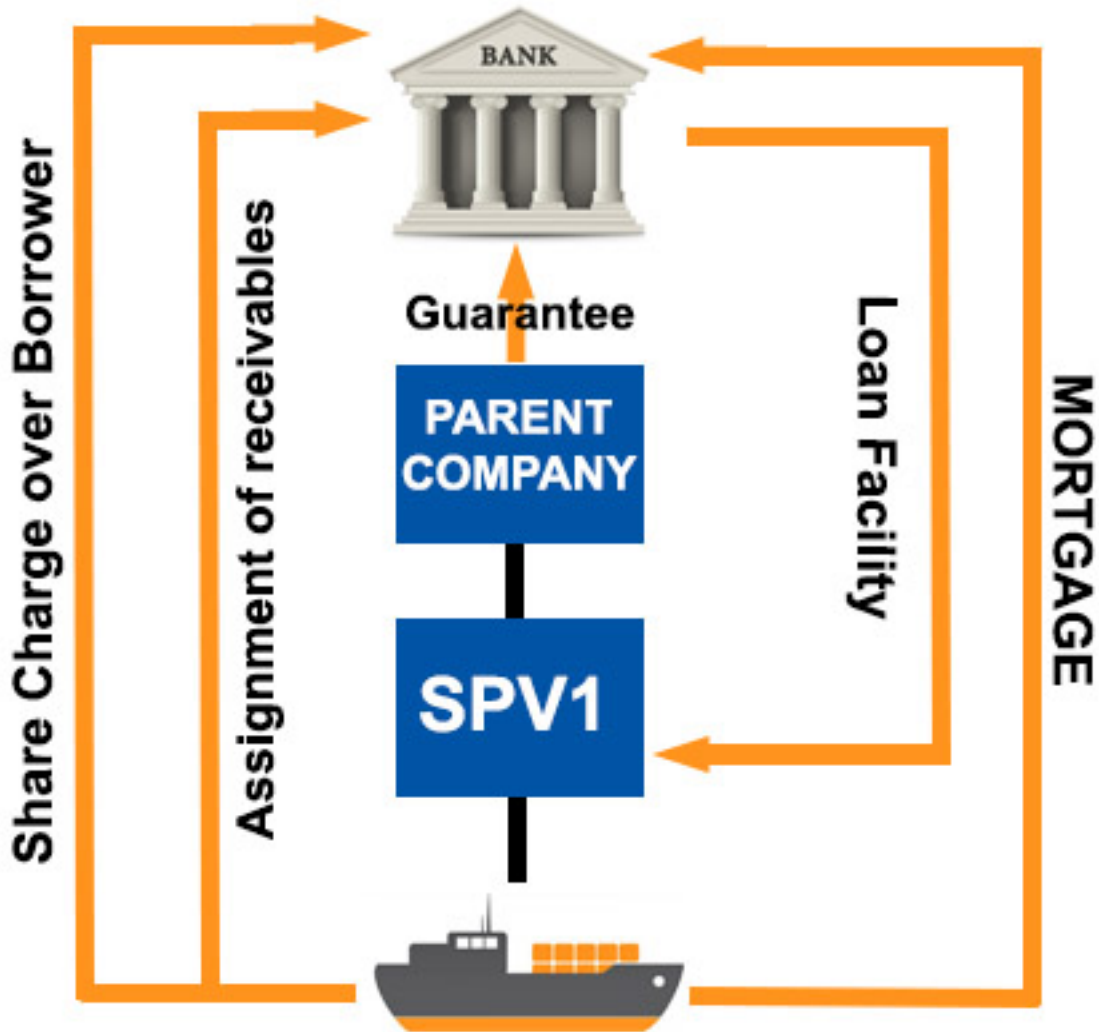
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# Traditional Scenario



# Traditional Security Package

## Share charges

In case of a default, lender can demand the appropriation or the judicial sale of the shares.

## Disadvantages:

1. Once shares are sold/appropriated, the new shareholder steps in shoes of the existing owner. Consequently, he/she takes over company with all existing debts and dues.
2. There is an indirect transfer of vessel – but no clean title.



# Traditional Security Package

## Assignment of receivables

In the case of a default, the borrower assigns to the lender all its receivables including:

- Hire
- Freight
- Earnings
- Insurance proceeds

## Disadvantage

If the vessel is not trading or is arrested/detained – the lender may have no receivables to go after.

# Traditional Security Package

## Guarantee

Corporate - given by borrower or parent company

Personal – given by a natural person (usually ultimate beneficial owner)

## Disadvantage

The recent collapse of Hanjin Shipping Co Ltd in Korea has shown that no group of companies is too big to fail!

Therefore, even a guarantee from a parent company may end up not worth the paper it is written on.

With respect to guarantees given by the ultimate beneficial owner, no assurances that he has enough assets to satisfy debt



# Mortgage security rights



# The Enforcement of **mortgage security rights**

## ***RIGHTS OF A MORTGAGEE***

Article 42 of the Merchant Shipping Act (Chapter 234 of the Laws of Malta) provides a list of rights which a mortgagee may exercise on the occurrence of an **event of default** of any one or more of the terms or conditions of a registered Maltese mortgage or of any document or agreement referred to therein



# The Enforcement of **mortgage security rights**

Once there is an event of default, the mortgagee upon giving notice in writing to the mortgagor, shall be entitled to:

1. **take possession** of the vessel or share therein;
2. **sell the vessel** or share therein **privately** (here the vessel will **not** be sold free and unencumbered)
3. carry out, in the name of the owner, those things which may be required in order to **maintain the status and validity of registration of the vessel** such as apply for extensions, pay fees and receive certificates;
4. demand a **judicial sale by auction** in Malta or to request a **court of approved private sale** (in such cases the vessel would be sold free and unencumbered).



# The Enforcement of mortgage security rights

Under Maltese law, a validly registered mortgage is considered an **executive title**.

This essentially means that a mortgagee may immediately proceed with rendering the mortgage enforceable **without the need for lengthy or tedious court proceedings**.

The mortgagee must simply file a **judicial letter** for payment before the Civil Courts, First Hall, calling upon the debtor to settle all the outstanding indebtedness within 2 days

The said judicial letter is then served on the debtor and/or vessel, as the case may be.

# The Enforcement of mortgage security rights

If the due debts are not settled within **two days** from service of the same judicial letter, then the mortgage is immediately rendered enforceable.

Following the lapse of the said two days, the mortgagee is free to immediately proceed to request the judicial sale of the vessel opting for either:

***A JUDICIAL SALE BY AUCTION***

OR

***A COURT APPROVED PRIVATE SALE***

# What about Foreign Mortgages?

These are given the status of a Maltese Mortgage **if:**

1. Such mortgage has been **validly recorded** in the registry of ships of the country under whose laws the ship is documented
2. Such registry is a **public registry**
3. Such mortgage **appears upon a search** of the registry
4. Such mortgage is granted a preferential and generally **equivalent status** as a mortgage under the Act.

# Judicial Sale by Auction

Similar enforcement mechanism as the judicial sale by auction of other movables and immovables – however there are some specific rules which apply only to vessels.

# Ship Arrest in Malta: Quick and Efficient

There is **no minimum price** threshold or minimum starting price for vessels being sold by judicial sale by auction

## ***Advantages of opting for an judicial sale***

- Quick and Efficient
- Relatively Inexpensive
- Creditor may be proactive (to some extent) through advertising
- Creditors may opt to bid *animo compensandi*

# Judicial Sale By Auction

## *Main Disadvantage*

You can never know with certainty the sale price of the vessel. Therefore, you will not know whether there will be enough funds to satisfy your credit, or even part thereof.

# Court Approved Private Sale of a Vessel

The 2006 amendments to the Code of Organisation and Civil Procedure saw the introduction of a new enforcement mechanism, the Court Approved Private Sale.

A mortgagee can choose to find its own private buyer to purchase a vessel at any predetermined price, so long as the court is satisfied that the said price is beneficial to all creditors of the vessel.

**NEVER USED UNTIL THE SALE OF THE M.V. THOR  
SPIRIT IN 2011**



# Court Approved Private Sale of a Vessel

Since then it has become the preferred route of enforcement for mortgagees as it gives them the **ability to negotiate** with buyers in order to obtain the best possible price for the benefit of all creditors and the owners.

To date there have been **18 application** filed before the Maltese Courts requesting the approval of a private sale, and bar one all had been approved.

# Court Approved Private Sale of a Vessel

## ***PROCEDURE***

- The mortgagee carries out **two physical valuations** of the vessel to establish the market price
- The mortgagee must then **find the potential buyer** of vessel offering the best price for the vessel
- Once the best offer has been identified, the mortgagee and the potential buyer sign a **Memorandum of Agreement**, subject to the Court's approval.

# Court Approved Private Sale of a Vessel

## *PROCEDURE*

- The mortgagee must then file **an application** requesting the court's approval of the sale and submitting the two valuations as well as evidence that the sale is also in the interest of all other creditors.
- Once the **court approves the sale**, the money is deposited in court and the vessel is transferred free and encumbrances to the purchaser.

# The Ladybugs - The Perfect Example

## *A Ladybug*

Warrant of Arrest issued on the **28 March 2015**

Judicial Letter Filed on the same day – 28 March 2015

Court Approved Sale on the 28<sup>th</sup> April 2015

First Valuation – USD 53.5 Million

Second Valuation – USD 55 Million

Vessel sold for **USD 56 Million**

Bill of Sale issued on the **14<sup>th</sup> May 2015**

# The Ladybugs - The Perfect Example

These cases were perhaps the most complicated to date for several reasons :

- **Abandoned seafarers**
- **Large size** (over 230+ meters)
- **No bunkers/ supplies being furnished** by owner
- Broken Anchors – **Broken Parts/equipment** (All three)
- **Salvage** Operation
  
- Numerous other creditors
- Corresponding US Chapter 11 proceeding on bankruptcy (A and D Ladybug)
- Assignment of security rights to new mortgagees

# Court Approved Private Sale of a Vessel

*Why is this mechanism becoming **so popular**?*

- It gives the mortgagee a proactive option to obtain **certainty in respect to the sale price** which a judicial sale by auction does not offer.
- It also gives a prospective buyer the peace of mind that it **will purchase the vessel free and unencumbered**.
- The applications go before the same Judge, who has now acquired a great understanding and a wealth of knowledge in the field.

## THE DEVELOPMENT OF THE COURT APPROVED PRIVATE SALE PROCEDURE THROUGH RECENT CASE LAW

- The procedure has been on our statute books for over 10 years now
- Whilst there have been no statutory amendments, the courts have helped develop and fine tune the system through case law

# 1. THE COURT APPOINTED PERSON AND THE RELEVANT JUDICIAL COSTS

One of the first issues which case law has helped solve relates to the judicial costs associated with procedure.

In the first court approved private sale (the MV Thor Spirit) the Court appointed the person from the official list of court curators.

Our statutory tariffs regarding court costs and expenses provide that such a person is entitled to **one percent (1%)** of the sum deposited into court.



# 1. THE COURT APPOINTED PERSON AND THE RELEVANT JUDICIAL COSTS

## MV EMMA SOPHIE

- The Court accepted that the parties could nominate (in the MoA) the name of a person (an advocate) to be appointed to role of the court appointed person.
- The parties **also agreed from beforehand on the fees** to be paid to the person they would nominated.
- This has now become **the standard** – and this approach has been used in every subsequent court approved private sale in Malta.



**Advantage -** Less court costs make the system more attractive

## 2. THE TWO VALUATIONS

Mortgagee bank must submit *“appraisements by two independent and reputable valuers confirming the value of the ship”*

The law does not prescribe the form or content of these two valuations.

The law does not state whether they must be entail physical inspections of the vessel or whether a desktop valuation is enough.

However, the Courts have delved into this issue on a number of occasions and the certain requirements have been clarified.

## 2. TWO VALUATIONS

The Maltese Courts will NOT accept desktop valuations.

Moreover, valuations **cannot have qualifications**

The general practice is to submit **one local valuation and one international valuation:**

However, there may be exceptions. In the sale of the **MV KAY**, the mortgagee bank submitted two valuations carried out by two local valuers. In order to give more weight to their valuations, the bank had the valuers swear their **valuations on oath**. The Court took this into consideration when approving the sale.



### 3. IDENTITY OF PURCHASER

The Court has also made some clarifications regarding the **identity of the purchaser**



#### **M.V. BLANKENESE**

The Court stated that there is nothing to preclude a **shareholder of the debtor ship** owning company from setting up a new company to purchase the same vessel.

### 3. IDENTITY OF PURCHASER



#### M.V. D LADYBUG

The Court clarified that there is nothing wrong with the mere fact that there is a **commercial link or connection between the mortgagee bank and the purchasing company** as long as the other requirements of the law are fulfilled.

### 3. IDENTITY OF PURCHASER



#### M.Y. KAY

In this case, the Court allowed a mortgagee bank to apply for a court approved private sale to sell the vessel to itself and to pay *animo compensandi*.

Rather than paying the purchase price from its own pocket, the amount was **offset against the existing debt owed to the mortgagee.**

However, the Court cautioned that in such cases it was obliged to proceed with **more care**, to ensure that the purchase price was in the best interest of all other known creditors.

## 4. 'IN THE BEST INTEREST OF ALL CREDITORS'

In the MV B Ladybug Sale ,the Court explained that for the sale to be in the best interest of all creditors it is **not necessary that the purchase price obtained satisfies** either all the credit owed to the enforcing mortgagee bank and/or of all other known creditors.

What is essential is that in the given circumstances the purchase price is the **most advantageous to all creditors** and that all interested parties (including the owner) are given the right to be heard.

Generally speaking this equates to the '**best offer**' tabled.

## 5. DEVELOPMENTS AS TO WHAT IS ‘THE BEST OFFER’

Normally, this would be the **highest attainable price**.

However, our courts take a pragmatic approach:

In the **Pacific Future** the Court accepted that the offer received by the purchaser which took into consideration the fact that the said buyer would carry out the owner’s pre-existing obligation under a charterparty by agreeing to unload the cargo on board in Ukraine.

The Court accepted that in the given circumstances and given the condition of the vessel – this was the best offer.



## 6. PROOF OF 'THE BEST OFFER'

Over the years the court has given weight to the provision of the law which states that it is the MORTGAGEE which must “*adduce to the Court*” all the **evidence that the sale is in the best interest** of all creditors and the price is reasonable in the given case.

The **Burden of proof** is therefore incumbent on the mortgagee:

- **advert**s in at least one maritime newspaper/journal
- **invitations to tender** offers and to keep documentation and records of all the offers tabled.
- If the mortgagee engages the **services of a broker**, to present an **affidavit** from the broker explaining the various offers received and illustrating how the purchase price is the best offer received.



## 7. BUNKERS ON BOARD

During the sale proceedings of the **M.V. D Ladybug**, the court agreed to exclude bunkers on aboard the vessel from the sale procedure on the basis of a **retention of title** clause in the bunker supplier's terms and conditions.



## 8. DEVELOPMENTS IN RELATION TO THIRD PARTY PROPERTY

In the Ladybug cases, **Cronos Containers Ltd** requested that the Court excludes the trailers on board the vessels from the actual sales.

It is up to the owner of third party property to request that they are not sold together with the ship

Maltese law defines what **a ship** shall include together with the hull ... *“all equipment, machinery and other appurtenances as accessories belonging to the ship, which are on board or which have been temporarily removed therefrom.”*

The Court acceded to this request and in all three cases – the mortgagee bank, the prospective buyer and Cronos had to reach a conclusion on what to do with the trailers after the ship was sold: to discharge at Malta OR to discharge at another port of call

## 9. INSOLVENCY PROCEEDINGS AND JUDICIAL SALES

### THE EC INSOLVENCY REGULATION – THE MV BELUGA SYDNEY

Our Courts [albeit within the context of a judicial sale] have held that Council regulation (EC) No **1346/2000 of 29 May 2000 on insolvency proceedings did NOT frustrate in rem procedures in Malta such as judicial sales.**

The court based this decision on **Regulation 5(1)**, which expressly states that the opening of insolvency proceedings shall not affect the *in rem* rights of creditors over both movable and immovable assets belonging to the debtor which are situated in the territory of another member state at the time of the opening of insolvency proceedings.

## 9. INSOLVENCY PROCEEDINGS AND JUDICIAL SALES

A Ladybug and D Ladybug vessel were part of the T.M.T. Group which filed for **Chapter 11 bankruptcy** in the U.S.

The US Court issued an **extra-territorial stay** order to ensure no creditors arrest or bring any claim against the said two vessel or their owners.

Our Courts have declared that they are not bound by any such order issued by the US Bankruptcy Court.

Mortgagee banks however need to take into consideration the legal consequences within the US if they breach such order.

# European Enforcement Order for uncontested claims - EC Regulation 805 / 2004

- Mortgage qualifies as an “*authentic instrument*”
- If is also possible to render a Maltese Mortgage enforceable in Malta, obtain an EEO from Civil Courts and then sell the vessel in another EU Member State
- Or vice-versa.

# ***FUTURE CHALLENGES?***

## **Insolvency Issues:**

- So far “in rem” rights are deemed as **an exception** to the general rules of domestic insolvency law as well as under the EU regulation on Cross-Border Insolvency.
- If there were to be a shift in this trend, the effectiveness of our enforcement mechanisms could be seriously jeopardized.
- Enforcement Proceedings could be **stalled**.
- **Claw back period** – new security granted could be set aside – particular since it gives a preference to the lender over other creditors

# Thank you for your attention



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